

**COMPETITION, REGULATION AND BETTER GOVERNANCE**  
***'Expect the Unexpected'***

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*(The views in this paper are those of the author and do not necessarily reflect either the views or policies of the Competition Commission.)*

My thanks to David Parker for inviting me to speak, to David Grayson, and also to Anglo American for sponsoring and hosting this important seminar. May I also congratulate each of them for their foresight in choosing a topic which has moved centre stage, and is likely to remain there for the foreseeable future.

We're meeting in extraordinary times which have already led to the conventional wisdom underlying economic, financial and commercial activity, as well as the role of government, being challenged on many fronts. Today is therefore an ideal opportunity to consider both the conventional wisdom and the challenges, even if it may be premature to be sure about the outcomes.

My subject might have been specially worded for the traditional graveyard slot but it is highly relevant and I hope will encourage discussion. For reasons I'll come to, perhaps I should have called it 'Expect the Unexpected' which might be more enticing!

I'll begin by addressing some of the key changes in the competition regime over the last decade. I'll then look at their impact on the governance of the Competition Commission, and of companies in the private sector. Next, I'll examine the boundaries between the competition regime and regulation. I'll then turn to governance, principally corporate governance. And to conclude, I'll draw out some key themes which we might discuss later this afternoon. I will focus mainly on the UK but much of what I have to say applies equally in the international arena, not least the USA and Europe where the focus, trends, and underlying influences are very similar.

So let me now turn to the UK competition regime and its relevance to governance in two respects. First, its impact on the need for companies to put in place compliance programmes. And second, how the Commission conducts its business in line with the same principles as companies in the private sector, some of whom may, of course, become the subject of our inquiries.

In relation to the competition regime itself, from the very start of the current UK Government's administration in 1997, it regarded competition policy as a key element in promoting a strong, competitive economy leading to economic growth and prosperity. The new Government moved quickly to overhaul competition law, bringing in the Competition Act in 1998 followed shortly afterwards by the Enterprise Act in 2002.

The Competition Act prohibits agreements, business practices and behaviour that have, or are intended to have, a damaging effect on competition in the UK. There are two different

prohibitions. The first is the Chapter I prohibition covering anti-competitive agreements which have an appreciable effect on competition. This includes collusion by competitors on customers, markets, prices or output. The second is the Chapter II prohibition which prevents businesses that are dominant in a market from abusing that position through activities such as predatory or discriminatory pricing. In essence, these mirror the provisions of Articles 81 and 82 in the EU legislation. Businesses that breach the Competition Act can be fined up to 10 per cent of their UK turnover for three years and may be liable to claims for damages from those they have harmed. To encourage disclosure of wrongdoing, there is a leniency policy which provides incentives for the first to blow the whistle to the competition authorities of up to 100 per cent of the fine.

After only four years, the Government introduced higher penalties and still tougher powers of investigation through the Enterprise Act.

The additional measures include:

- (i) first, a criminal cartel offence carrying a sentence of up to five years imprisonment and/or an unlimited fine; it is directed at individuals and operates alongside the Competition Act's civil law procedures against companies involved in cartels;
- (ii) second, disqualification of directors for breach of either UK or EU competition law; and
- (iii) third, increased powers to obtain evidence.

Meanwhile, similar developments were taking place in Europe with the introduction of the Modernisation Regulation at the time of enlargement in 2004 and the simultaneous Reform of the EC Merger Regulation.<sup>1,2</sup> Among other things, the former placed a greater onus on companies to assess for themselves their obligations under competition law and removed the facility to obtain exemptions on certain agreements.

In terms of the impact on corporate governance, the important point to appreciate is that the penalties for anti-competitive behaviour fall not just on companies but also on individuals, including directors and employees, and can be severe. Accordingly, as a matter of prudent governance, depending on the nature of a company's business, it may be appropriate to introduce and manage a formal compliance programme. For these to be effective, they must be much more than just a formal box-ticking exercise. They require not only the commitment of senior management but also a culture and system of values throughout the organization that recognize the importance of compliance to the achievement of the company's wider objectives.

Reverting to the Enterprise Act, this also reformed the measures which covered behaviour in the conduct of firms which, although not illegal, still results in the market not being competitive and, therefore, detrimental to consumers. This is sometimes referred to as 'uncompetitive' behaviour to distinguish it from the anti-competitive behaviour under Chapters I and II that I have just described. Such uncompetitive behaviour may occur as a result of the merger of two individual firms. Alternatively, it may result from the features, or a combination of features, of a whole market which prevent, restrict or distort competition.

The Enterprise Act introduced important changes to the powers and procedures for investigating potentially uncompetitive situations through either the merger or the market investigation regimes.

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<sup>1</sup>The Modernisation Regulation changed the framework for enforcement by granting a larger role to national authorities and enabling EU Member States to apply Articles 81 and 82 directly.

<sup>2</sup>The EC Merger Regulation introduced a new competition test, which is similar though not identical to the new tests in the UK, as well as greater flexibility to transfer cases to or from Brussels.

Merger inquires and market investigations lie at the heart of the work of the Commission, the successor to the Monopolies and Mergers Commission, the MMC, which is the oldest such authority in Europe having just celebrated our 60<sup>th</sup> birthday.

The Enterprise Act has had a significant impact on our work in two key areas, specifically our powers and our procedures.

Looking first at our powers, the Government wished to take politics out of merger control and Ministers are no longer responsible, or even involved, in the vast majority of merger and market cases. Previously, the Secretary of State was involved in making referrals, in decisions on the substance, and in remedies. Now, Ministers are only involved through very limited so-called 'public interest gateways' of which there are just three: national security; certain aspects of media; and most recently, financial stability. In the current climate, the public interest is receiving much more attention and I will come back to some of the consequences. Overall, however, the Commission is now determinative in deciding the outcome of almost all merger and market investigations. We also determine and usually implement the remedies.

The test against which both merger and markets cases are evaluated by the Commission is now strictly one of competition; a substantial lessening of competition in the case of mergers and an adverse effect on competition in the case of markets. Previously, the test was one of the 'public interest', and while over the years this had come to be interpreted very largely in terms of the effects on competition,<sup>3</sup> it was broader and less clear-cut than the new tests. The involvement of Ministers also broadened the scope for interpretation.

Turning to our procedures, these have been thoroughly revised to provide greater openness, fairness and transparency. They are published in the form of procedural and economic guidelines to ensure that anyone affected by a Commission inquiry understands the process they are involved in; what the Commission is doing; why and how we are doing it; what is expected of each of them; and the timetable. Before taking final decisions, we consult on our proposed decisions, setting out the underlying evidence and reasoning. Final decisions on both the competition issues and on any consequent remedies can be appealed to the Competition Appeal Tribunal, known as the CAT.

Having found a competition problem, the Commission will almost invariably remedy it itself, and has the power to do so, usually by requiring the sale of a business, or part of it, or by introducing controls over the way it manages its business, notably on contracts or prices. In some cases, however, we make recommendations for the remedy to be implemented by others, usually government. We are required to achieve a solution that comprehensively and effectively addresses the specific competition problems identified and one that is both reasonable and practicable. Subject to being effective, our remedies must be proportionate—this usually means the least costly and least intrusive. Our approach to remedying competition problems is, therefore, entirely in line with the Government's principles of better regulation, specifically those of transparency; accountability; proportionality; consistency; and being targeted only at cases where action is required.

Let me now concentrate on those areas of the merger regime which, when the Enterprise Act was introduced, were excluded from the new brighter line competition test, and were retained for determination by Ministers under a public interest test.

Until very recently, the Secretary of State could intervene under the Enterprise Act through two public interest gateways. One concerns mergers which might have an impact on national

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<sup>3</sup>Competition, rather than the public interest, had been at the heart of merger decision-making since 1984, when the 'Tebbit' doctrine was introduced by the then Secretary of State, Norman (later Sir Norman) Tebbit and reiterated by almost every subsequent Secretary of State in the Conservative and Labour Governments until the Enterprise Act became effective in 2003 when the test was formally changed.

security (including public security), and the other, various considerations relating to the media, notably plurality. A third public interest gateway was introduced by the Government last October to address mergers in conditions of financial instability; this was in response to concerns that HBOS might collapse, with serious knock-on effects on the banking system as a whole. I will come back to this in a moment.<sup>4</sup>

So let me look at two cases which have been considered under a public interest test, BSkyB/ITV and Lloyds TSB/HBOS, the first of which involved the Commission, the second did not.

Most merger cases are referred to the Commission by the OFT.<sup>5</sup> The BSkyB/ITV case was different and was the first public interest merger to be referred to us under the Enterprise Act. It arose from BSkyB purchasing in the market a 17.9 per cent shareholding in ITV. Because BSkyB and ITV were both media companies, there was the possibility that any competition concerns might need to be considered by the Secretary of State under the media public interest gateway. After considering advice from the OFT on the competition issues<sup>6</sup> and advice from Ofcom on whether it raised media plurality issues, the Secretary of State referred the case to the Commission on both grounds. We advised that while the acquisition created a competition problem,<sup>7</sup> we did not expect it to operate against the public interest. We recommended a partial divestiture of BSkyB's shareholding in ITV to below 7.5 per cent, combined with an undertaking not to seek or accept ITV Board representation. The Secretary of State accepted our advice on all counts.<sup>8</sup> The decision was then appealed to the CAT and it has now gone to the Court of Appeal.<sup>9</sup>

The Lloyds TSB/HBOS case is different in that it was never referred to the Commission. The OFT carried out its normal competition assessment and found that there was a realistic prospect that the anticipated merger would result in a substantial lessening of competition.<sup>10</sup> However, the Secretary of State used his powers under the new financial stability gateway to intervene, and decided on public interest grounds that the merger could proceed without a reference to the Commission.

In summary, therefore, while most mergers are considered against the pure competition tests introduced under the Enterprise Act, there is still not only scope for mergers to be considered under a public interest test but it is also clear that the Government is prepared to use its public interest powers and indeed, possibly introduce new gateways where it considers this to be appropriate. Furthermore, while the Commission may investigate such cases, and while it is determinative on the competition assessment, it is for Ministers to decide on matters of the public interest, albeit having taken into account advice from the Commission.

Let me now look briefly at the boundaries of competition and regulation which have received growing attention, including by some of you here today.

When competition authorities talk about the boundaries with regulation, they tend to focus on the relatively narrow area of regulation of utilities and other similar regulated businesses. Regulation, however, is pervasive and now affects almost every element of our lives.

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<sup>4</sup>The Government can also intervene under the EC Merger Regulation to protect what are termed 'legitimate interests'. The Government's freedom of action is, however, constrained by EC law more generally, not least in terms of state aid.

<sup>5</sup>Office of Fair Trading.

<sup>6</sup>Including whether the acquisition of a minority stake at such a level qualified as a merger.

<sup>7</sup>Due to the loss of rivalry between ITV and BSkyB.

<sup>8</sup>Both on the acquisition and on remedies.

<sup>9</sup>The CAT upheld the decision on the competition assessment but not the interpretation of aspects of the media public interest test. However, the CAT did not refer the case back to the Commission on the grounds that the Commission's remedy to require BSkyB to reduce its shareholding below 7.5 per cent would be unaffected by the alternative interpretation of the media public interest test. The Court of Appeal agreed to hear the case on 17 March 2009.

<sup>10</sup>In relation to personal current accounts, banking services for small- and medium-sized enterprises and mortgages.

Economic regulation, as we know it today, developed in the UK from the need, on privatization, to regulate the former nationalized industries, most of which were monopolies with limited scope for immediate competition. Starting with gas, telecoms and airports, economic regulation quickly moved on to water and electricity, and ultimately rail and postal services. It was expected that over time the need for economic regulation would reduce as competition was introduced into at least parts of the regulated industries. While such competition has indeed developed, in some cases quite widely, and is now being introduced into the regulated airports and water, the role of the economic regulator has expanded significantly as the scope of such regulation has increased. As a measure of this, when OFTEL was being set up in 1983, it was expected to have a staff of 50. Today its successor, Ofcom, employs over 800 people, admittedly with responsibilities which go far beyond those of OFTEL.

So where are the boundaries between competition and regulation and particularly between the relevant institutions? Also, might we expect current circumstances to cause some of the boundaries to shift?

In terms of the competition authorities, both the OFT and the Commission are actively involved in regulation. The OFT has specific consumer regulation and competition responsibilities. The Commission's involvement in regulation is essentially two-fold. First, when conducting a merger or market inquiry, having found a competition problem, as I have mentioned, we can impose either structural remedies; or alternatively, behavioural remedies which are essentially regulation by another name. Second, we have a number of important roles in the economic regulation of airports<sup>11</sup> and certain appeals of the regulated industries.<sup>12</sup> Conversely, not all competition powers rest with the competition authorities and the sectoral regulators, in addition to their regulatory powers, have concurrent competition powers with the OFT in relation to the Competition and Enterprise Acts. In short, the boundaries between the competition and regulation authorities are multi-faceted with many overlaps.

As to how current political, economic and financial conditions might impact on the workings of the competition and regulatory regimes, I have already referred to the introduction of the financial stability public interest gateway. So far, this has only been used in the Lloyds TSB/HBOS merger but as the Secretary of State has made explicit, it is not restricted to the banking and financial sector and could equally be used in other situations. We certainly cannot ignore the growing influence of the public interest and there may be other developments.

Let me now turn to governance, and particularly corporate governance.

The starting point is the Combined Code on Corporate Governance, generally referred to as the Code, issued by the Financial Reporting Council, or FRC, most recently in June 2008. This took effect at the same time as the FSA<sup>13</sup> introduced new Corporate Governance Rules to implement European requirements relating to audit committees and corporate governance statements.

The underlying principle of the Code is that good corporate governance should contribute to better company performance by helping a Board discharge its duties through facilitating efficient, effective and innovative management to deliver shareholder value over the longer

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<sup>11</sup>Notably in the quinquennial review of airport charges as well as appeals against modifications of licences of regulated companies, energy code modifications and telecommunications price control matters in appeals to the CAT.

<sup>12</sup>Prior to the airports' regulator, the Civil Aviation Authority (CAA), making its final determination of airport charges at the beginning of each quinquennium, it is obliged under the Airports Act 1986 to make a six-month reference to the Commission. The Commission's decisions are by way of recommendations to the CAA, other than in respect of any public interest findings which the CAA is obliged to accept though it has latitude on the precise way in which the decisions are implemented.

<sup>13</sup>Financial Services Authority.

term. The Code exists to support these outcomes and promote confidence in corporate reporting and governance. If it is ignored, performance may be impaired with increased vulnerability to takeover.

The Code is far from new, having been in operation since 1992, though it has continued to be revised following a series of reviews either on corporate governance as a whole or on specific aspects, such as those by Turnbull, Hampel, Smith and ultimately Derek Higgs in 2003. Each step was a response to either or both of an increased recognition that standards of governance needed to be improved and of specific events such as the collapse of Enron and its auditors, which led to the Sarbanes-Oxley Act in the USA.

The Code is not a rigid set of rules. While it is expected that companies will comply wholly or substantially with its provisions, it is recognized that non-compliance may be justified in particular circumstances if good governance can be achieved by other means. A fundamental tenet is that where Boards do not comply with the Code, they are required to explain why, hence the term 'comply or explain'.

Companies listed on the Main Market of the London Stock Exchange are required to report to shareholders annually on their corporate governance arrangements.

The obligations for good governance do not, however, fall just on companies and their Boards. As the FRC has made clear, companies and shareholders have a shared responsibility for ensuring that 'comply or explain' remains an effective alternative to a rules-based system. Satisfactory engagement between Boards and investors is therefore crucial to the health of the corporate governance regime.

The principal components of the Code encompass first, the structure, composition and workings of the Board and its committees.<sup>14</sup> Second, the formal evaluation of the performance of the Board, and of its committees and individual directors.<sup>15</sup> Third, the appropriate composition of the Board.<sup>16</sup> Fourth, the structures and workings of the key Board committees.<sup>17</sup> And last but not least, the conduct of relationships with shareholders.

The Code is much less focused on certain aspects of governance which elsewhere are receiving greater attention than hitherto. It says very little about important matters such as, for example, corporate social responsibility and the environment. I am aware that other speakers will be sharing their thoughts in these areas and I will not therefore consider them in any detail. One of the key issues, however, is the extent to which companies regard them as objectives in themselves or merely constraints on their prime objective of delivering value for shareholders. A related question is whether such value can be delivered if these wider interests are not fully taken into account and become an integral part of a company's governance philosophy and structures.

The question then arises as to what the enormous changes, and accompanying efforts, in improving corporate governance have actually delivered. In many respects, I have little doubt that a great deal has been achieved. Most of the evidence suggests—and this accords with my own experience—that Boards, and their committees, are better structured in terms of having the requisite skills and experience; are more professional in terms of how they fulfil their responsibilities; are more transparent in terms of what they do and decide; and strive harder to develop, improve and adapt. Indeed the FRC itself, which is tasked with reviewing

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<sup>14</sup>This includes the respective roles of the Chairman and Chief Executive; the balance between the Executive and Non-Executive Directors (and in particular, independent Non-Executive Directors); procedures for the appointment of directors, and the provision of information to directors.

<sup>15</sup>With a requirement that this should be done annually and reported on to shareholders.

<sup>16</sup>Including how directors are appointed; for them to be subject to re-election at regular intervals; for their total terms to be limited, generally to nine years; and for there to be mechanisms progressively to refresh Board membership.

<sup>17</sup>Notably audit, remuneration and nomination committees.

the Code periodically, said in June 2008 that it was ‘generally reassure[ed] about the Code’s content and impact’.

And yet, and yet! Corporate governance may not be achieving all that it should. Leaving aside the accusations of ‘box-ticking’ which is an easy target and often unproductive in terms of real substance, more disclosure does not always mean greater transparency. Too often we confuse more data with more information. Reports of Remuneration Committees are a good example. And I hope our hosts, Anglo American, who are in the forefront of those who espouse and practise better corporate governance, will forgive me if I refer to their own Remuneration Committee report. It covers no less than 11 tightly packed pages and is enormously comprehensive but dare I say, there is so much disclosure that it is difficult to see the wood for the trees. But deciding on what the wood should be is itself extremely difficult, not least in a very large, intricate international organization. Too often the complexities with which Boards have to grapple in this area alone are overlooked in meeting the expectations of those who want simple answers.

Staying with remuneration, I was struck by the answer to a rhetorical question posed by a Minister in the Lords with a City background who asked a recent gathering of NEDs how many in RBS we thought might have earned more than the former Chief Executive, Sir Fred Goodwin, who was himself regarded as scarcely being badly paid. Indeed, in the light of recent events, that might be an understatement! The answer he said was a hundred or so. But that was not disclosed as there was no legal or other requirement to do so. In terms of understanding what was actually happening in the business, maybe that kind of information might be relevant to external stakeholders.

The same may be true when a company issues a prospectus to list its shares or raise new equity or debt capital. These are drafted with painstaking care to ensure they meet legal, FSA and other regulatory requirements. However, the result is often a document running to several hundred pages, including a hefty chunk devoted to risk factors which can be so all-embracing that it can be difficult to appreciate which are the really significant ones that bear on investment or other decisions. Sometimes they may appear as much to satisfy the lawyers seeking to protect the company, its directors and dare I say, their own position, as inform prospective investors! In other words, plenty of disclosure but not always great transparency.

So too in the area of risk management where most companies have moved forward in leaps and bounds with many, though not all, having separate risk management committees. There is now widespread acceptance that this is an important area for any Board. Leaving aside the question of the most appropriate organizational structure—and to my mind this depends very much on the nature of a company’s business and its size and complexity—the essential points are first, that overall, risk management is ultimately the responsibility of the Board and second, that to be effective it needs to be embedded throughout the organization, not only in terms of process and procedures but also, and at least as important, in its philosophy and values.

As I have said, corporate governance has the prime objective of delivering value for shareholders and in order to do so, it must also explicitly recognize the legitimate interests of shareholders and other stakeholders.

So what of those shareholders and their own responsibilities? The Code emphasizes the need for Boards to engage with their shareholders but experience suggests this is more easily said than done. Again while there has been progress, with the Association of British Insurers, the ABI,<sup>18</sup> taking a leading role, shareholders have had their own part to play in the shortcomings of governance, often preferring just to sell a company’s shares rather than

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<sup>18</sup>Effectively the UK’s principal trade association for institutional investors.

engage with the Board when matters seem not to be going well. Many shareholders are not even interested in meeting a non-executive Chairman, never mind the senior non-executive director, preferring instead to see only the Chief Executive and Finance Director and focus on the short-term earnings outlook. The challenges to develop shareholder relationships have been exacerbated, at least until recently, by the rapid changes in the composition of a company's shareholder base, particularly with the burgeoning role of the hedge funds. It is difficult to establish long-term relationships if shareholders are not long-term holders.

Just as significant, shareholders have also shown an inclination to support a Board and the company's management even when to do so may have encouraged them to take that 'step too far'. RBS's acquisition of ABN Amro may be a case in point but it is not an isolated event, nor a particularly new one. Take for instance the support for GEC's acquisition programme in the USA in 1999 when the institutions continued to buy the shares up to £12.50 before reality dawned and they fell back to earth, collapsing to below £2.50, after which the very same shareholders condemned the Board and management for their ill-judged actions. Most recently, press comment suggests that some institutions may now be questioning the Lloyds TSB acquisition of HBOS, which they themselves voted through. Indeed, dare I speculate that some might now have preferred a reference to the Commission!

Arguably, much of what I have said is no more than common sense, and yet recent experience suggests that we may have got it all very wrong so the key question is why? And I am not just thinking of the banks, which might justify a seminar on their own—and indeed they have already engendered their own industry with an almost daily focus from the Government, Parliament, the media and other commentators. However, in today's climate the banks might be regarded as the low hanging fruit for criticism and it is anyway not for me to express a view. But they are far from alone. Wherever we look, we are witnessing some of the greatest changes in companies' ability to perform, and in many cases to survive, including a significant number of major industrial and commercial enterprises ranging from cars and steel to retail.

So where have we gone wrong and what should we now do? To which I might reply 'how long have we got'? But let me share a few thoughts which might provoke some discussion as the afternoon progresses.

On the matter of where we might have gone wrong, I am confident that the answer does not lie in a navel gazing focus on the corporate governance Code. It has to be much bigger than that; after all to blame the Code and compliance, or maybe lack of it, for not only the near collapse of the world's banking system but also an economic slowdown of almost unprecedented proportions seems a little harsh.

I am not an economic historian, and some of my colleagues at the Commission might not regard me as even an economist. However, allow me to share a few personal thoughts. It is more than 40 years since I was introduced as a Cambridge undergraduate to Maynard Keynes, not literally as he died the year after I was born, though I was privileged to study under his pupil, Joan Robinson, habitually dressed in black Chinese trousers which today might be regarded as very fashionable!<sup>19</sup> So why do I seemingly digress? For two reasons. First, it was Keynes who led me to believe that governments were now able to control economies. Second, that following his courageous efforts at Bretton Woods in 1944, when he was already in terminally ill health, international cooperation between governments would avoid the competitive devaluations and selfish national economic policies which had ravaged the 1920s and 1930s.

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<sup>19</sup>It was Joan Robinson who famously retorted, in response to Keynes's remark that 'in the long-term we are all dead', 'but not all at the same time'!

So why do I mention all of this? The reason is that to understand what has gone wrong and what we might do, requires more than the conventional conclusion that it can all be explained by 'fear' and 'greed'. I have no doubt that both of these are important drivers but there is more to it than that. In essence, I believe that companies and their shareholders, and indeed governments, regulators and individuals, were all lulled into a false sense of security and well-being. That is to say we came to believe that politics aside, while major economies would have their ups and downs, sectors would grow or even decline, and companies would have good times and bad, governments and companies could by and large manage their way through to a bigger, better and brighter future, through an almost unbroken virtuous circle. One of the many outcomes was that individuals, companies, banks and governments all took on too much debt with the awful consequences which have become all too apparent.

As part of this, we came to believe that we understood risk and could manage it. And many a risk management committee and their respective Boards have proceeded on that basis. What we may have understood rather less well is that risk does not equate to uncertainty. I realize that there is a whole world of academic thought devoted to the differences. But in essence, as I see it, risk is capable of measurement in one way or another, that is to say a one in 'x' or one in 'y' probability. At the Commission, in deciding if a merger constitutes a significant lessening of competition, our test is 'more likely than not' and while this may not be capable of precise measurement, it is capable of being assessed by an expert body on the basis of the evidence. But uncertainty falls outside the arena of risk; it is the unexpected and the unknown.

So why is this relevant? Not because companies should set up an Uncertainty Committee, heaven forbid, but to emphasize that first, some of the underlying assumptions we have hitherto taken for granted may have been wrong and second, that in a more uncertain world, decisions by Boards need to recognize the implications of 'getting it wrong'. Or as I said at the start they should 'expect the unexpected'.

Let me give you a couple of examples.

First, banks and indeed central banks had come to assume that systemic risk would be reduced through the diversification of asset portfolios both domestically and internationally. In essence, banks put together a portfolio of their assets which they transferred to other banks or investors. This freed up the transferring bank's balance sheet for further lending and was assumed to spread the bank's risk as well as improve capital efficiency. Whether or not that was so, it is clear that the quality of the packages of assets being transferred deteriorated over time and instead of comprising obligations from prime borrowers came to be composed of assets of increasingly doubtful quality and ultimately, the so-called sub-prime and toxic CDOs. In essence, the consequence was that banks could no longer assess the underlying risks in their portfolios and had slipped into the realm of very considerable uncertainty, making proper assessment and decision making extremely difficult, if not nigh impossible.

My second example of decision making under conditions of uncertainty is very different and is taken from the Commission's review of airport charges at Stansted in 2008 during a six-month period which, by historical standards, was exceptional in terms of the economic and financial uncertainties. Airport charges are expressed in per passenger terms and the key determinants in forecasting passenger numbers are oil prices, economic growth and consumer expenditure. Oil prices alone moved from around \$100/bbl at the start of our inquiry in April to over \$140/bbl before halving to below \$70/bbl in October, with further falls then widely predicted. They have subsequently fallen to around \$40/bbl. Setting firm charges for airports, and for other regulated businesses, for five years against such an uncertain background is really a topic in itself but it demonstrates how difficult decision taking can be when we lose the comfort of the levels of certainty we had previously taken for granted.

So to finish, let me draw some of my themes together and particularly how competition policy and regulation link with corporate responsibility and governance.

Let me start with competition. If economies are to recover and companies develop and thrive, competition policy must surely remain as a core element in economic policy. Indeed, the benefits of competition in terms of driving down costs and prices; stimulating innovation and improvements in productivity; and increasing choice, all of which ultimately benefit the consumer, are even more important in a recession. This applies equally at the level of the economy as a whole, where we must remain true to the principles of Bretton Woods and avoid economic nationalism and protectionism. Unfortunately, the recent tendency for the banks increasingly to restrict lending to their domestic markets may be a bad omen.

The competition regime must, of course, be responsive to changes in the political, economic and financial climate. However, we must be careful not to over-react and jettison the proven benefits of competition policy and lurch into excessive intervention and over-regulation. Indeed, I suggest we do so at our peril. This is not to deny that inevitably there will be increased government intervention and increased regulation, including increased requirements for corporate governance,<sup>20</sup> particularly greater transparency. It is important, however, that such increased regulation is balanced and proportionate, and continues to accord with the principles of better regulation I mentioned earlier. There is a danger that unfocused and heavy-handed measures will do more harm than good and may be difficult to reverse in the longer term. Any intervention during current circumstances should, therefore, be timely but temporary, transparent and applied indiscriminately across the board.

The terms of government intervention will inevitably come at a price and rightly so where large sums of public money are at stake. Enterprises that receive such support must expect also to receive greater scrutiny with the public interest receiving greater attention. However, it is not only these enterprises that will be held accountable. So too will government.

I have just one more question. Will reliance on competition policy, more and better regulation and responsible government intervention be sufficient? My answer is 'almost certainly not' for two reasons. First, no matter how many join the army of regulators, and however able or diligent they may be, they cannot substitute for good management and balanced judgement. And second, technical compliance with external regulation is not enough. Equally important, I suggest, is self-regulation or self-governance. That is to say both companies and the individuals within them must act responsibly, ethically and with integrity. Government, regulators and public bodies inevitably play a role in establishing effective compliance and regulatory programmes. However, it is just as much the responsibility of companies and individuals to ensure their behaviour meets the standards of conduct the public rightly expects and deserves.

So, to conclude. Where is this all taking us? It is hard to say but in these uncertain times, if I have one final message, which ties together competition, regulation and governance, it is simply this: 'expect the unexpected'!

19 March 2009

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<sup>20</sup>On 18 March 2009, the Chairman of the FSA, Lord Turner, announced an overhaul of the UK's financial regulatory regime; on the same day, the Chairman of the FRC, Sir Christopher Hogg, announced a review of the impact of the Code on Corporate Governance.